



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Release Number: **200926037**  
Release Date: 6/26/09  
Date: 3/31/2009  
UIL Code: 501.32-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:  
1120

Tax Years:  
Future Years

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. Normally at this point, we solicit the filing of tax returns on Forms 1120 for your completed tax years. However, as noted in the proposed denial letter that we sent you, you did not established a separate accounting system apart from the related for-profit hotel in which you operate. Consequently, you should establish a separate accounting system, which will enable you to file separate tax returns on Forms 1120 in the future. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting all identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Rob Choi  
Director, Exempt Organizations  
Rulings & Agreements

Enclosure  
Notice 437  
Redacted Proposed Adverse Determination Letter  
Redacted Final Adverse Determination Letter



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: January 2, 2009

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

A: state  
B: date  
C: state Law  
D: religion  
E: charity  
F: individual  
G: individual  
H: individual  
I: business  
J: church  
K: city  
L: address  
M: business  
N: individual  
O: business  
o: dollar amount  
P: business  
p: dollar amount  
Q: business  
q: dollar amount  
R: business  
r: dollar amount  
S: individual  
s: dollar figure  
T: schools  
U: churches  
V: applicant  
w: dollar amount  
X: business  
Y: dollar amount  
Z: dollar amount  
aa: dollar amount  
bb: dollar amount  
cc: dollar amount

UIL Index:

501.32-00  
501.33-00

Dear

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

### **Issues**

Does the applicant qualify for exemption under section 501(c)(3) of the Code?

### **Facts**

#### *Formation*

V was an A corporation formed on date B under the laws of C.

#### *Purposes*

The Articles of Incorporation state the purposes of V are:

- a. To conduct and maintain a house of worship in accordance with D faith
- b. To conduct and maintain a seminary for the purpose of education young men of the D faith in the Bible
- c. To foster the spirit of D faith
- d. To provide and maintain a community center for communal, civic and social activities
- e. To establish and conduct classes, clubs and lectures on social, civic, cultural, moral and religious subjects
- f. To conduct and maintain a gymnasium and other facilities for physical improvement
- g. To participate in all civic and communal acts for the betterment of the community.
- h. To establish, maintain and operate day care centers for children
- i. To establish, maintain and operate a religious E
- j. To purchase property, both real and personal property and to mortgage and lease both real and personal property as may be necessary for the conduct and welfare of the corporation
- k. To conduct any and all other activities as shall from time to time be appropriate in accordance with the foregoing and as lawful for corporations organized under C

#### *Governing controls*

The governing body of the organization is comprised of three individuals: F, G and H. All three have both family and business relationships. H is the mother of F and G and all three have

6.25% ownership interest in the same partnership, I.

### *Activities*

V states their primary purpose is operating a J church in city K, offering daily services. Services take place at L, which is owned by M. A lease is in place for the rental of the property. V does not have a set religious leader, but rather services are led by N or other service participants.

M is owned by I, mentioned under governing controls, above.

In addition to J church activities V offers a short term interest free loan society, or E, where money is lent interest free to anyone who makes a request. V indicated the following giving structure with regards to board authorization:

\$500 or more approved by entire board  
 \$500 or less approved only by treasurer, documentation required by recipient  
 \$75 or less no documentation required, approved only by treasurer

To date the following loans have been made for the listed purposes:

3/23/     O, to be able to pay Cash on Deposit (COD) and buy in bulk at a discount (o\$)  
 7/24/     P, to be able to pay COD and buy in bulk at a discount (p\$)  
 5/22/     Q, Short term cash flow problem (q\$)  
 8/05/     R, to relieve the cash flow until the receivable will be collected (r\$)  
 8/27/     S, pay off Credit Card (CC) debts and save interest (s\$)

Copies of board approvals of these loans in the form of meeting minutes as well as copies of loan applications were provided in correspondence.

The board of V has a related partnership affiliation to R. In addition, S is the son of H, the treasurer of V.

While V will make loans they stated they did not anticipate making outright distributions of funds or grants. However, a ledger provided with correspondence dated December 26, 2007, shows the following distributions were made between the dates of March 2007 through October 2007:

Three distributions under \$75

Eight distributions made of \$500 or less

Twenty distributions made of \$500 or more

Included in these distributions were memos indicating payments made for 'insurance for sick'

and a contribution for a building fund. The recipients of these funds were numerous organizations including T and U.

In total, for a six month period V showed income of approximately y\$. Of that, z\$ was made for the non-charitable loans. Amongst other expenses attributable to V to date are charitable contributions made totaling nearly aa\$. Smaller amounts for everyday operating expenses and rent make up the remainder of the funds expensed. bb\$ was transferred to a money market account of which approximately cc\$ remain.

V's sources of support to date have been a contribution of a 20% interest in a property owned and sold by X in K in addition to w\$ of membership fees.

### Law

Section 501(a) of the Internal Revenue Code of 1986 provides for the exemption from federal income tax for organizations described in Section 501(c)(3). Such organizations are recognized as exempt if they are organized and operated exclusively for religious, charitable, and educational purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities in not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

In Salvation Navy v. Commissioner, T.C.M. 2002-275 (2002), the court found that one of the reasons why the organization did not qualify for exemption from federal income tax was because it could not provide that its net earnings would not inure to the benefit of a private individual which was its founder.

In Old Dominion Box Co. v. United States, 477 F2d 344 (4<sup>th</sup> Cir. 1973) cert. denied 413 U.S. 910 (1973), the court held that operating for the benefit of private parties constitutes a substantial



non-exempt purpose.

Leon A. Beeghly v. Commissioner, 35 T.C. 490 (1960), provided that where an exempt organization engages in a transaction with a related interest and there is a purpose to benefit the private interest rather than the organization, exemption may be lost even though the transaction ultimately proves profitable for the exempt organization.

In Basic Bible Church v. Commissioner, 74 T.C. 846 (1980), the court found that although the organization did serve religious and charitable purposes, it existed to serve the private benefit of its founders, and thus failed the operational test of section 501(c)(3). Control over financial affairs by the founder created an opportunity for abuse and thus the need to be open and candid, which the applicant failed to do.

In De La Salle Institute, a membership corporation v. United States of America, 195 F.Supp. 891 D.C.Cal (1961), the court found that the operation of a chapel, although considered very important to the organization's religious purposes, was found to be incidental to the organization's principal activities to operate a school and winery. An incidental worship activity can not make the organization a church with the court stating that the tail cannot be permitted to wag the dog. The chapel in this case was regarded in itself a 'church' and would have been so regarded if they did no more than operate one or two chapels. However in this case the organization did much more than operate a chapel.

In Church in Boston v. Commissioner of Internal Revenue 71 T.C. 102 (1978) the court found that the organization's officers received amounts of money in the form of "grants." These grants carried with them no legal obligation to repay any interest or principal. Petitioner contended, as it had during the administrative proceeding before the IRS, that the grants were made in furtherance of a charitable purpose: to assist the poor who were in need of food, clothing, shelter, and medical attention. However, petitioner was unable to furnish any documented criteria which would demonstrate the selection process of a deserving recipient, the reason for specific amounts given, or the purpose of the grant. The only documentation contained in the administrative record was a list of grants made during one of the three years in question which included the name of the recipient, the amount of the grant, and the "reason" for the grant which was specified as either unemployment, moving expenses, school scholarship, or medical expense. This information was insufficient in determining whether the grants were made in an objective and nondiscriminatory manner and whether the distribution of such grants was made in furtherance of an exempt purpose.

The failure to develop criteria for "grant" disbursements or to keep adequate records of each recipient can result in abuse. Accordingly it was found that the organization failed to establish that their disbursements constituted an activity in furtherance of an exempt purpose.

Rev. Rul. 56-262, 1956-1 C.B. 131 provides that in order to be recognized as a church under the Code, an organization must have as its principal purpose or function that of a church.

### **Application of Law**

V meets the organizational test in part as the purposes of the organization have been set forth to meet requirements under section 501(c)(3) as being religious. However, the charitable giving

activities of V are questionable as loans have already been made for non-charitable purposes. They do not meet the operational test as net earnings have inured to private individuals and board members. Further, despite the organization's religious activities as evidenced in the above court rulings merely having as activities religious purposes does not constitute passing the operational test when private interests are served. The expenses of V indicate purposes of fund distribution to be the primary function; not the operation of a church.

### **Applicant's Position**

In regards to their church activities, V has stated in the application for exemption and in correspondence that they are operating a J church with the intention to expand in the future.

In regards to their loan activities they have stated 'D commandments forbid them to lend money on interest to a fellow D. Therefore we lend money interest free to anyone that requests a loan'. Funds are given to anyone in need. V has also stated in their attachments to the application for exemption that if needed funds would be given to a related individual.

### **Service Response to Applicants Position**

While V may be operating religious services they do not meet the operational test as inurement and private benefit are evident in several areas. Also, it can be questioned whether or not V meets the organizational test in full as portions of their activities do not exclusively further 501(c)(3) purposes; specifically, their free loans.

All three of the board members are related creating the potential for private control of V. They have stated that board members are not disqualified from receiving loans/aid from V despite their relation and control. This resulted in a loan being made to R which is affiliated to I; owned in part by the board. This constitutes direct private benefit and inurement. Further, the loan had no charitable purpose as its stated intention was to relieve a cash flow problem.

A loan was made to the treasurer's son which again constitutes direct private benefit and inurement. This loan had no charitable intent as its stated purpose was to allow for the payment of credit card debt.

The other three loans were not made to related parties but nonetheless further the private interests of each recipient as their stated purposes were to help their businesses.

Each of the five loans made by V are questionable as the intent of each loan does not appear charitable. While the loan documentation stipulates a return of a contribution in lieu of interest, thereby potentially lessening the private gain of a loan, this does not appear to have occurred. Each appears to be furthering the private interest of an individual or business causing both private benefit and inurement. And as can be seen from the expense breakdown for only a six month period the majority of V's expenses are attributable to these non-qualifying loans.

The facility being leased and paid for by V is also used by I/R, which is partially owned by each board member. I also owns M, which holds legal title to the building. So the facility being leased by V is not only being simultaneously used by for-profit operations owned in part by the board, but the building itself is owned by for profit entities controlled by the board. The entire lease and use of the facility is one large related party transaction of which the governing body benefits.



As seen by the sources of support V has been funded almost entirely by an entity owned in part by the governing body. They have made seemingly no attempt at raising funds publicly through donations, tithing or membership fees as normally seen with service oriented religious entities. Further, the projections provided on page 9 of Form 1023 are grossly undervalued compared to the actual income generated by V. This calls into question the validity of information presented within the application and the intention of V to mislead or misdirect additional questions presented in the development of the determination.

Overall, while V does conduct religious services, the loan activities they have directed disqualify them from exemption as the structure and intention has only served related parties and private interests. The organization itself seems to be an outlet for distributions from a related for profit entity for the purpose of distributions loans. While by definition some of the recipients of these loans could be deemed needy the purposes listed for which the loans were made further no 501(c)(3) purposes in eliminating direct charitable need. The facts in the application and supplemental correspondence show that the board had been controlling all aspects of V for their private interests and not for the benefit of the public.

### **Conclusion**

Based on the facts presented above, we hold that you do not meet the requirements for tax exemption under section 501(c)(3) of the Code.

The transactions that have occurred constitute private benefit and inurement. An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Accordingly, you do not qualify for exemption under section 501(c)(3) of the Code because you do not meet the prescriptions stated in the aforementioned Treasury Regulations.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal

as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

**Mail to:**

Internal Revenue Service  
EO Determinations Quality Assurance  
Room 7-008  
P.O. Box 2508  
Cincinnati, OH 45201

**Deliver to:**

Internal Revenue Service  
EO Determinations Quality Assurance  
550 Main Street, Room 7-008  
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Certified Mail Returned as Undeliverable:

We originally mailed the proposed denial letter to you on 12/2/ via certified mail. On 12/22 the Post Office returned that mailing to us. On the original envelop, the Post Office stated, "This Name Not On Any Mailbox – Unknown." We reviewed your file and discovered that you seemed to have received prior non-certified mailings at this address. We therefore revised the 12/2/2008 proposed denial letter by adding this section and we mailed the revised proposed denial letter to you via regular mail. You now have 30 days from the date of the revised proposed denial if you wish to protest in the manner described above.

Sincerely,

Robert Choi  
Director, Exempt Organizations  
Rulings & Agreements